CHAPTER 2. UNDERWRITING

SECTION 1. COST ESTIMATION

2-1. GENERAL. In processing an application under Section 231, the Underwriting instructions and procedures set forth for the basic Section 207 Rental Housing Program shall be followed, except as modified herein.

2-2. COST ESTIMATION AND PROCESSING. Proposed projects submitted under this Section are estimated and processed according to basic Section 207 procedures except as modified herein. Refer to references (6) and (7) in the Foreword.

a. The Supplemental Estimate for Costs Not Attributable to Dwelling Use also includes the costs for "special spaces and accommodations." The Cost Analyst will collaborate with the Design Representative to identify the improvements to be included.

(1) Generally the improvements consist of amenities, services and facilities not usually found to the same extent in typical rental projects and which provide for the comfort, health and recreation of elderly persons.

(a) Included are such spaces as a multi-purpose room which may be used on occasion, but not exclusively for, religious purposes, infirmaries, medical treatment and consultation rooms, game rooms, libraries, reading rooms, hobby and craft shops, barber and beauty shops, lounges or sitting rooms and snack bars.

(b) Income producing spaces are classified as commercial and are not considered as special spaces; however, such spaces are included as "commercial" in "Costs not Attributable."

(2) Also included are central kitchens and dining rooms, but only to the extent of the excess over that required to serve living units with no cooking and dining accommodations.

(3) As with other Costs Not Attributable items, the costs of foundations, plumbing, heating, air conditioning, water, electric, and/or sewage facilities are prorated to the "special spaces" as appropriate. Not included are central bathing facilities in those projects where individual bathing facilities are omitted.

(2-2) b. For Profit Type projects there will be no allowance for a Builder's Profit. Only the Builder's General Overhead will be included, and a Builder's and Sponsor's Profit and Risk Allowance will be made by the Valuation Section. A typical builder's profit will be assumed in determining the dollar amounts for Architect's Fees. These derived amounts are divided by the total for structures, land improvements, general requirements and general overhead, in order to secure the percentages to be shown on FHA Forms 2326 and 2264.

SECTION 2. LAND PLANNING ANALYSIS

2-3. LAND PLANNING ANALYSIS. Projects will be analyzed by Land Planning personnel keeping in mind the special needs of the occupants and their reduced physical ability.

a. Design.

(1) Provide grades to eliminate or reduce steps and steep inclines;

(2) Provide nearby parking facilities;

(3) Include suitable areas for mild recreation activities;

(4) Reduce the length of travel between frequent use areas;

(5) Stress safety in the selection and use of materials;

(6) Provide access and egress tailored to the needs established by the construction and the adjacent thoroughfares.

b. When Rent Supplement Programs are involved, due consideration shall be given to types of planting and other exterior improvements designed to provide economy in installation and maintenance costs.

SECTION 3. ARCHITECTURAL ANALYSIS

2-4. ARCHITECTURAL ANALYSIS - SECTION 231. Projects are processed in accordance with outstanding instructions for Section 207, modified as follows.

a. Minor existing structures are eligible within the project only if construction, space, and facilities equal or exceed that required in proposed construction.

b. The Design Representative determines that the design and the materials specified are related to the limited physical ability of the occupants. For example: Access and egress shall take into consideration the infirm and handicapped. Ramps shall be provided where necessary.

c. The Design Representative checks these additional design considerations :

(1) Planning designed to assist the management function;

(2) Facilities for deliveries;

(3) Visitor parking.

SECTION 4. VALUATION ANALYSIS

2-5. VALUATION ANALYSIS - SAMA STAGE PROCESSING, PROPOSED CONSTRUCTION. Procedures will conform to the instructions for Section 207, and Sama stage processing as contained in reference (6) of the Foreword.

a. Location Analysis: Location is of the utmost importance in the success of any housing development. The necessity of a convenient location for a project for the elderly is as well established as in any other program. The elderly population should not be thought of as a captive market. Their needs and conditions vary widely and can be met by a considerable range of new and existing housing. Remote or isolated locations are to be avoided.

(1) It is essential that residents of projects for the elderly have ready access to religious institutions, to a full range of shopping facilities, including restaurants, and to various kinds of recreation. This usually requires convenient and reasonably priced public transportation.

(2) Shopping facilities for day-to-day necessities such as groceries and drugs should be within walking distance, or delivery at reasonable cost must be available.

(3) Convenience of location to others upon whom the residents of the project will depend is also important. The location should be readily accessible to project employees, some of whom may require public transportation, as well as to doctors and other medical personnel.

(4) Elderly people tend to tire more easily and their vision may not be too keen, so steepness and unevenness of topography should be avoided.

b. Evaluating Market Demands: A rental project of any kind depends on income. Market demand, which is the measure of the breadth and continuance of the need, desire, and ability to pay for housing, is the basis for the estimate of income. It is, therefore, vital to the long-term success of the project that the extent and composition of market demand and the estimated income from the rental of living quarters and utilities be determined and reported, regardless of the nature of the sponsorship.

(2-5) c. Basis of Income Estimates: The appraiser will be responsible for estimating the market rental value of the proposed units. This is accomplished through comparison of the proposed unit rents with the rents obtainable in the market for comparable units which provide equivalent living accommodations and services.

d. Congregate Living: Congregate living facilities may be considered by any eligible mortgagor. He may propose to supply tenants with food, furniture, maid service, health insurance, infirmary, limited nursing care, or other personal services.

Regardless of the nature and extent of the congregate facilities provided, each dwelling unit shall contain at a minimum; a kitchen sink, a minimum size standard refrigerator, a "cook top," adequate electrical capacity and outlets for small appliances, storage space for food and utensil storage and complete bathroom facilities. Where a mortgagor proposes to furnish food or other services, the sponsor shall clearly separate such charges from the total charges for shelter, rent and utilities which are entered on FHA Form 2013. Also, the sponsor's FHA Form 2013 should contain only those expenses estimated to be required to supply living quarters including utilities. FHA Form 2013-E will be used to show estimated expenses and income relating to meals and other services.

e. SAMA Determination: Processing will be in accordance with Section 207 instructions except that a finding of value will not be made. A SAMA letter may be issued when data indicates that the site is acceptable and that a market exists for the number and type of units proposed at the stated market rents.

f. Conditional Commitment Stage: Another FHA Form 2013 and preliminary plans are received from the sponsor in accordance with agreement reached at the SAMA conference concerning features of an acceptable project. All technical decisions concerning acceptable design and MPS compliance, the estimated cost of the project, the as is value of the site, the detailed estimates of operating expenses and taxes, the supportable cost, the financial and credit capacity of the sponsorship, cash requirements, and the mortgage amount are determined at this time. All applicable processing, data and documentation forms will be completed in their entirety at this time. The land value, the market rents and the LUI are carried over from SAMA Stage unless changes in the sponsor's proposal require reanalysis.

(2-5) g. Firm Commitment Stage: At this stage, final plans and specifications are reviewed. With a Design Representative assigned to the project, there should be conformity with previous concepts and decisions agreed upon by HUD-FHA and the sponsor, and there should be no changes in plans which are not approved by HUD-FHA as design progresses. Again, reanalysis is limited to changes necessitated by sponsor actions. Otherwise, all HUD-FHA decisions previously made must stand.

h. Rehabilitation Projects - (Non-Profit and Profit-Motivated

Organizations) - involve rehabilitation of existing structures, proposed additions, or proposed construction on a property having existing structures. Valuation Processing shall be completed in accordance with outstanding instructions for Rehabilitation Projects, Reference (5) of the Foreword.

SECTION 5. MORTGAGE CREDIT ANALYSIS

2-6. MORTGAGE CREDIT ANALYSIS. Mortgage credit procedures and analysis are to be completed in accordance with underwriting instructions under Section 207, except as modified herein.

a. Non-profit Mortgagor. When the project is sponsored by a nonprofit corporation or association (as defined in the FHA Regulations under Section 231.2) the mortgagor must:

(1) Be a fraternal, religious, charitable or other non-profit organization having among its objectives a recognized interest in furnishing adequate housing for aged persons;

(2) Be possessed of sufficient financial capacity to provide the funds which will be required for completion of the project, and a reasonable amount of operating capital to carry the project during initial occupancy, and

(3) Have the business background and experience necessary to undertake and provide competent management for the project. This determination is most important as the humanitarian objectives must be supported by realistic and experienced management.

2-7. AMOUNT AND AMORTIZATION PERIOD OF LOAN. Analysis of the credit risk is premised upon a loan for a definite amount and amortization period. In the conditional and firm commitment stages, it will be the amount applied for but not to exceed the maximum amount permitted under the statutory and regulatory limitations under Section 231 of the National Housing Act.

a. Principal Obligation and Term. The mortgage must involve a principal obligation in an even multiple of $100 and a term not appreciably in excess of three-fourths of the remaining economic life of the building improvements, but not to exceed 40 years.

b. Amount of Loan - New Construction. This includes all projects not involving rehabilitation or reconstruction of existing structures. Insurable mortgage amount may not exceed the lowest of:

(2-7) (1) 100% of the HUD-FHA estimate of the replacement cost of the property or project when the proposed improvements are completed, if executed by a Private Mortgagor-Non-Profit or a Public Mortgagor.

(2) Amount attributable to dwelling use, excluding exterior land improvements, not to exceed:

(a) WALK-UP STRUCTURES:

$12,300 per family unit without a bedroom.

$17,188 per family unit with one bedroom.

$20,525 per family unit with two bedrooms.

$24,700 per family unit with three bedrooms.

$29,038 per family unit with four or more bedrooms.

(b) ELEVATOR TYPE STRUCTURES:

$13,975 per family unit without a bedroom.

$20,025 per family unit with one bedroom.

$24,350 per family unit with two bedrooms.

$31,500 per family unit with three bedrooms.

$34,578 per family unit with four or more bedrooms.

(c) The Mortgage Amount may exceed the limits stated in subparagraphs b.(2)(a) and (b) above by the cost not attributable to dwelling use, including exterior land improvements.

(d) The Assistant Secretary-FHA Commissioner may increase the per family unit dollar amount limitations by an amount not to exceed 45% in any geographical area where he finds cost levels so require.

(3) An amount which entails a debt service not in excess of

95% of the estimated net income.

e. Rehabilitation. This includes only those projects involving the rehabilitation or reconstruction of existing structure(s). If the project is designed for congregate living and it is a successfully operating project which does not need substantial rehabilitation, but needs additions to existing facilities, the new construction can be considered as rehabilitation. Congregate living for this purpose is defined as that which entails the use of community dining room(s), kitchen(s), and other facilities. In such cases, projected budgets must support the financial soundness of the expanded project and demonstrate that the additional operating expense will not result in an overall diminishing return.

f. Amount of Loan-Rehabilitation. Insurable mortgage amount will not exceed the lowest of:

(1) The amounts set forth under new construction, except that the limitations under subparagraph c thereof shall be on HUD-FHA estimate of value rather than replacement cost.

(2) Property-Owned - HUD-FHA estimated current cost of rehabilitation plus the lesser of (e) principal amount of existing indebtedness against the property, if any, and closing charges, or (b) the HUD-FHA estimate of value of the property before rehabilitation and closing charges (less value of leased fee, if leasehold, ana/or principal amount of special assessment, if any).

(3) Property to be Acquired - HUD-FHA estimated current cost of rehabilitation plus the lesser of (a) the actual purchase price of the property and closing charges, or (b) the HUD-FHA estimated value of the property before rehabilitation and closing charges (less value of leased fee, if leasehold, and/or principal amount of special assessment, if any).

2-8. DETERMINATION OF ESTIMATED REQUIREMENTS FOR COMPLETION OF PROJECT. The development of the financial requirements for completion of a multifamily project for the elderly is essential for the subsequent analysis of the mortgagor's financial capacity to provide the required funds. The analysis determines the net amount of cash required to close the transaction. This is accomplished by totalling the HUD-FHA estimate of the replacement cost of the property or project, and the estimated cost of off-site improvements. See reference (8) of the Foreword.

a. Rehabilitation Projects. In projects involving rehabilitation, the requirements will be based on the HUD-FHA estimate of the cost of rehabilitation plus (1) the actual purchase price of the property and closing charges, or (2) the principal amount of the indebtedness against the property and closing charges, if rehabilitation involves property already owned. From this total is deducted the maximum insurable mortgage. The remainder will represent the estimated capital requirements for the realty.

b. Operational Capital. Further capital will generally be required for projects for the elderly to defray all costs of placing the project in immediate operation as operational income will be vital to proper mortgage liquidation. This will include cost of all capital expenditures necessary to the basic operation of the project such as furniture, supplies, equipment, and other expenditures not covered by the proceeds of the insured mortgage. The sponsors will be required to submit with their application separate detailed cost schedules covering each of the proposed additional facilities of this nature.

c. Cost Schedules. These schedules will be reviewed for the purpose of estimating the reasonableness of such cost. Subsequent information may be obtained if there is evidence of inconsistencies or errors in the estimates. Funds for these installations must be in form of a permanent investment. Basic financial requirements for completion of the project and cost of placing it in condition for immediate operation will be computed by use of FHA Form 2264A. The cost of furnishings, equipment, etc., will be added by memorandum to the "Working Capital Requirements for the Project," in Part B, Item 3C on FHA Form 2264A.

2-9. DETERMINATION OF MORTGAGOR'S ABILITY TO CLOSE TRANSACTION AND PROVIDE OTHER CAPITAL ASSURANCES OF FINANCIAL CAPACITY TO OPERATE THE PROJECT (Nonprofit Mortgage). Projects for the elderly involve more extensive financial consideration than other multi-family projects, in that they entail more than a rental market debt service relationship. The soundness of the transaction involves capitalization and successful operation of a business providing all living facilities for elderly persons.

a. As fundamental credit considerations in the analysis of a multifamily project for the elderly, the mortgagor must submit evidence to show:

(1) That the mortgagor has the total needed capital available for investment in the project and in the required items of equipment and furnishings not covered by the proceeds of the mortgage,

(2) That funds can be provided to supplement the deficiency in net income during the initial period of partial occupancy, if any is indicated by HUD-FHA processing, and

(3) That the mortgagor can furnish capable and experienced management for this highly specialized program.

b. Plan For Project Operations. A comprehensive outline of the plan for operating the project should be furnished by the mortgagor together with supplementary schedules of operating costs not directly related to the project which have not been included in the application form or project analysis. These include cost of attendants, operating community dining and recreation facilities, operation of infirmaries, and ether operating costs of this nature. The reasonableness of these estimates will be studied as a primary responsibility of the Mortgage Credit Section/Branch. In many instances it will be necessary to obtain additional supplementary information from both the sponsors and outside sources.

c. The Mortgage Credit Examiner will make an over-all estimate of the income and total estimated expenses of the project using the above information. On the basis of this information the examiner will write a memorandum for the file stating his opinion as to the ability of the mortgagors to provide all of the capitalization, debt service, and continuing operating expenses of the project.

2-10. INSURANCE OF ADVANCES - INITIAL ADVANCE. When the mortgage transaction provides for insurance of advances during the construction period, any of the mortgage proceeds in excess of the amount required for on-site construction, contingency reserve, if any, architect's fee, carrying charges, financing, legal and organization expense, the consultant's fee, if any, and allowance included in replacement cost to make the project operational, where applicable, will be allocated to the acquisition cost of land in accordance with the limits prescribed under Section 207.

The amount allocated to legal and organization expense will equal the HUD-FHA estimate. Amounts advanced for legal fees are limited to actual fees accrued through initial endorsement, but in no instance exceed 75% of that portion. Organizational fees are limited to the amount substantiated as earned.

2-11. PRIVATE MORTGAGOR-PROFIT. When a mortgagor is a Private Mortgagor-Profit, as defined in the Regulations under Section 231.2(i), mortgage credit procedure and analysis are to be completed in accordance with Underwriting instructions under Section 207 for Rental Housing, except as modified herein.

a. Amount of Loan - New Construction - includes only those projects not involving the rehabilitation or reconstruction of existing construction. The insurable mortgage will not exceed:

(1) 90% of the HUD-FHA estimate of the replacement cost of the property or project when the proposed improvements are completed.

(2) Amount attributable to dwelling use, excluding exterior land improvements, not to exceed:

(a) Walk-up Structures:

$12,300 per family unit without a bedroom;

$17,188 per family unit with one bedroom;

$20,525 per family unit with two bedrooms;

$24,700 per family unit with three bedrooms; and

$29,038 per family unit with four or more bedrooms.

(b) Elevator Type Structures:

$13,975 per family unit without a bedroom;

$20,025 per family unit with one bedroom;

$24,350 per family unit with two bedrooms;

$31,500 per family unit with three bedrooms; and

$34,578 per family unit with four or more bedrooms.

b. An amount which entails a debt service not in excess of 90% of the estimated net income.

c. The Assistant Secretary-FHA Commissioner may increase the per family unit dollar amount limitations by an amount not to exceed 75% in any geographical area where he finds cost levels so require. The mortgage amount may exceed the limits in paragraphs a.(2)(a) and (b)) above by the cost not attributable to dwelling use, including exterior land improvements.

d. Amount of loan - Rehabilitation - includes only those projects involving the rehabilitation or reconstruction of existing structure(s). Insurable mortgage amount shall not exceed the lowest of:

(1) The amounts set forth under new construction, except that the limitation under criterion 2-11. a.(2) thereof, will be the HUD-FHA estimate of value rather than replacement cost.

Property owned - HUD-FHA estimated current cost of rehabilitation plus the lesser of:

(a) Principal amount of existing indebtedness against the property, if any, and closing charges, or

(b) 90% of the HUD-FHA estimate of value of the property before rehabilitation and closing charges (less value of leased fee, if leasehold, and/or principal amount of special assessment, if any), or

(3) Property to be Acquired - 90% of the HUD-FHA estimated current cost of rehabilitation plus the lesser of:

(a) 90% of the actual purchase price of the property and closing charges, or

(b) 90% of the HUD-FHA estimated value of the property before rehabilitation and closing charges, and/or principal amount of special assessment, if any).

2-12. INSURANCE OF ADVANCES. Follow basic instructions as modified for nonprofit organizations.

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2-13. OPERATING LOSS LOANS - TWO YEAR OPERATING LOSSES. Pursuant to the provisions of Section 223(d) of the National Housing Act, the mortgagor may request (and the Assistant Secretary-FHA Commissioner may insure) an operating loss loan to cover the excess of taxes, interest, mortgage insurance premiums, hazard insurance premiums, and the expense of maintenance and operation of the project over project income during the first two years following the date of completion of the project. Mortgage credit processing shall be completed in accordance with basic instructions for Operating Loss Loans - Two Year Operating losses. See reference (8) of the Foreword.

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